

WAITING FOR THE BANK TO FORECLOSE: A MODERN DAY STORY

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As I'm sure you are aware, in addition to association foreclosure actions there has been a dramatic and unfortunate rise in the number of mortgage foreclosure actions filed against owners within community associations. However, due to the decreased value of these properties caused by the Sub-Prime collapse as well as the real estate market bust, most mortgagees (lenders) are reluctant to complete their foreclosure actions.

The reasons why are numerous. So long as the properties are not foreclosed and taken back by the banks, they are still listed as an asset on the banks' books as opposed to a bad debt. In the near future, you will see many of these lenders merging and acquiring each other due to accelerated fallout which, experts predict, will continue to occur over the next 12 to 24 months. For purposes of acquisition or merger, losses on paper are always viewed more favorably than bad debt. Thus, the trend of lenders commencing foreclosure actions, but not concluding them, will likely continue.

Please consider the following illustration:

In the market's heyday between 2005 and early 2007, a property that would have sold for \$400,000.00, today has a market value of \$240,000. Assume that same \$400,000.00 property has a first mortgage for \$320,000 and a second for \$70,000.00. Now that the value has dropped below the amount of the first mortgage, the property is identified as being "Upside Down." However, the home's upside down status is purely a *paper loss* as long as the bank does not acquire title to the property. As such, the bank sees no advantage to taking the property back through foreclosure in these present market conditions. In fact, once the bank completes its foreclosure action it must do the following:

1. Pay attorney's fees and costs associated with same, as well as any bankruptcy legal costs;
2. Rehabilitate and repair the property usually as a consequence of any gutting or destruction caused by the delinquent owner(s);
3. Pay for property preservation and carrying costs of the property, i.e. insurance, taxes and electric;
4. Pay for expenses associated with the eviction of the prior owner(s) or occupant(s) if they have refused to vacate the premises, as well as unpaid back taxes due and water/sewer charges owing;
5. Hire a realtor to market the property at 3% - 6% of sales price for commission and attempt to obtain a buyer in the present overstocked and low demand housing market;
6. Pay the condominium association 1% or 6 months past due maintenance assessments, whichever is less, within 30 days from issuance of title;
7. Pay the homeowners' association 100% of all that is owed in legal fees and costs as well as maintenance, late fees and interest within 30 days from issuance of title, if the property is taken back prior to July 1, 2008;
8. Pay the homeowners' association 1% or 12 months past due maintenance assessments, whichever is less, within 30 days from issuance of title, if the property is taken back after July 1, 2008;

9. Pay the condominium or homeowners' association for all regular assessments that come due from the date of issuance of title forward as well as any special assessments levied by the association for cash flow shortfalls due to high delinquency rates within the association or special assessments levied for any other reason; and
10. Continue to pay for all assessments levied, special or regular, so long as the title to the property remains in the name of the lender. Due to present unfavorable real estate market conditions, lenders could be forced to hold on to such properties for a long time.

As you can see, there are few, if any, benefits today for lenders to take title back to properties on which they have made loans. As a result, it is no longer advisable, in most circumstances, for associations to halt or suspend their own collection efforts in the hopes that the bank will "do the job" for them since banks will, in many circumstances, start the process and not complete it.

It is important to remember that the bank's liability for past due assessments is limited as stated above no matter how long they allow the foreclosure action to remain open. Thus, the bank can comfortably delay completing its foreclosure action knowing the full extent of its liability for past due assessments. This delay benefits the lender and the debtor; the only one damaged by the delay is the association and its paying members. Each month the association does not act to remove the non-paying owner, the following can occur:

1. Owners within the association who continue to pay their fair share of the common expenses will be aware that owners who are not paying are not being pursued by the association. As a result, the morale of these paying owners will suffer especially if non-paying owners are seen enjoying the benefits of membership including use of the common facilities, cable, water and insurance coverage;
2. The morale of paying owners may deteriorate to the point that they too stop paying their maintenance;
3. Delinquency rates may rise to the point that there will not be enough cash flow to properly operate the association and to provide essential community services;
4. Owners who can freely avoid paying their assessments may become emboldened to not abide by the association's use restrictions and Rules and Regulations. The resulting nuisances and violations will further erode community morale and may disturb the quiet enjoyment of other association members; and
5. The association will be unable to mitigate its damages by renting the property in the short term or attempting a short sale with a third party to try to re-coup some of its financial losses until its foreclosure action is completed.

Due to the backlog in the court system as a consequence of the volume alone, a mortgage foreclosure action that would normally take 4 to 6 months to complete is now taking a minimum of 9 to 12 months or longer. Association counsel has seen repeated delays of final hearings and the banks' counsel are no longer willing to provide status to inferior lien holders, like the association, as to when if ever these actions will be completed. In addition, a cottage industry has cropped up where borrowers fight their lenders over foreclosures due to lost promissory notes and other banking irregularities which can delay resolution of the mortgage foreclosure for years.

Prior to the bursting of the real estate bubble, it was common knowledge in this industry that a bank's action would be completed expeditiously from start to finish given the positive equity in most properties. Therefore, most associations immediately suspended their own collection efforts and

simply monitored the bank's action when they became aware of a pending mortgage foreclosure action. This usually resulted in the bank dispossessing the non-paying owner of the unit without additional legal fees and costs to be incurred by the association. In essence, they "did our job for us".

Obviously, the rules of engagement have changed as a result of market changes. There are several legislative proposals being discussed that will either hold lenders more responsible for past due assessments beyond the current statutory caps or force lenders to diligently pursue their foreclosure actions in non owner-occupied units in order to enjoy their limited liability. Regardless of the outcome of that legislation, it is essential that a community association with collection files speak to its attorney about how to best pursue the amounts owed to the community in order to continue providing essential community services.

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